Paying tax on pension benefits

Video transcript

This section is about paying tax once your benefits come into payment. Once you retire and take your benefits, you'll get an income for life and a one-off tax-free, up to certain limits, cash lump sum of three times your pension. You can choose to have a lower monthly income and a higher cash lump sum or vice versa; it's up to you.

There is a limit on the amount of benefits that can be taken tax-free though, and USS will tell you this limit when they send you your retirement quote. Your benefits options on retirement, including pension and lump sum options, are covered in more detail in the **Approaching retirement** webinar.

You may be taxed on the monthly pension income you receive depending on the total level of your income. Your tax code, provided by HMRC, will be used to calculate the tax payable on your income in retirement. And the amount of income tax you pay on your USS benefits will also be determined by any income you earn from other sources.

You'll generally pay income tax if your total annual income adds up to more than your Personal Allowance. And this income could include any State Pension that you receive, a private pension such as a personal pension, or a workplace pension like the one that you've built up with USS, employment or self-employment earnings, any taxable benefits you receive, and any other income that you might receive from sources such as savings, investments, or property.

In 2025/26 the Personal Allowance is set at £12,570 a year, or £1,084 a month. For anything that you earn over and above your Personal Allowance, you'll be charged the relevant tax rate. Again, this depends on your total income.

For the basic rate, which is currently between £12,571 and £50,270, you'll be charged 20% tax. For the higher rate, which is anything between £50,271 and £125,140, you'll be charged 40% tax. And for the additional rate, which is anything above £125,140, you'll pay 45% tax. These rates are slightly different in Scotland.

Also note that if your income is above £100,000 a year, your Personal Allowance actually reduces by £1 for every £2 over £100,000. That means your Personal Allowance is therefore zero if your income is £125,140 or above. So you would pay tax on the first £12,570 of earnings as well. For simplicity, all our examples assume the member has a full Personal Allowance.

Let's first look at the example of someone who is receiving the full State Pension of £11,973 a year and is receiving a pension from USS of £13,027 a year. This brings their total income from all sources to £25,000 a year, and so they pay income tax at a rate of 20%.

Their Personal Allowance is £12,570 and they would not pay tax on this level of income. Their remaining income is £12,430 and they would pay 20% on this, so £2,486. This means their total tax payable is £2,486.

We've also got an example of someone who has a full State Pension of £11,973 a year, but this time a pension from USS of £43,027 a year. So they receive an income of £55,000 a year. And I'm assuming this and the previous example, there's no other sources of income.

So this person is paying income tax at a rate of 40%, assuming they're not in Scotland. Their Personal Allowance is £12,570 and they would not pay tax on this level of income. Their income between £12,571 and £50,270 is £37,700, and they would pay 20% tax on this, so that amounts to £7,540 tax.

Their remaining income is £4,730 and they would pay 40% tax on this, so £1,892. This means their total tax payable is £9,432.

HMRC uses tax codes to tell your employer or your pension provider how much Personal Allowance you have to use on that income. Now depending on how much of your Personal Allowance you're using at other sources, you may not receive all of your Personal Allowance on your USS pension.

Until the HMRC issues a notification of a new tax code for your pension, USS may need use an emergency tax code. The emergency tax code assumes you've got the full £12,570 Personal Allowance available. This could result in a member paying too little or too much tax as it does not make any allowance for when in the tax year the payment starts or what other income a member might have.

Once your new tax code is confirmed by HMRC and in place, any adjustments will be made to your income tax. It's also useful to be aware that starting to receive any new pension or cash payments that impact your taxable income levels might push you into a higher tax band, or it might have an impact on your tax-free Personal Allowance, or it might mean that you need to complete a Self Assessment tax return.